

11th Annual
EMERGING
ISSUES
FORUM



Sustainable Investing

Investing for the Greater Good

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REVISED VERSION

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COMMONWEALTH OF MASSACHUSETTS

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Sustainable Investing

Investing for the Greater Good



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The SASB Mission

Improved non-financial disclosure results in enhanced market efficiency

Developing and disseminating sustainability accounting standards that help public corporations disclose **material, decision-useful information** to investors.

Utilizing a rigorous process that includes evidence-based research and broad, balanced stakeholder participation.



SASB is working to develop industry-specific standards to strengthen ESG disclosures and improve connections between sustainability performance and capital markets.

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A Growing Need

Global megatrends, economic evolution create challenges for companies, investors

LEGISLATIVE PRESSURE

- Mandates in multiple markets (E.U., China, India, etc.)
- Disclosure reform
- Exchange listing requirements

ECONOMIC PRESSURE

- Resource constraints
- Climate change
- Changing valuations and the rise of intangibles

INVESTOR PRESSURE

- Shareholder resolutions
- Questionnaire fatigue
- Calls for divestment

STATE OF DISCLOSURE

- Proliferation of boilerplate disclosures
- Inappropriate use of materiality in corporate communications

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NOTES:

The Evolution of Sustainable Investing

What's in a name? Impact Investing; Socially Responsible Investing; Environmental, Social and Governance (ESG) Investing; Sustainable Investing; "Non-Financial Considerations"; Corporate Social Responsibility...

"Investment process that integrates traditional financial analysis with non-financial ESG factors in an attempt to enhance long-term returns and manage risk in investment portfolios."

-Calvert Investments, "Perspectives on ESG Integration in Equity Investing", 2015.

Exclusionary Screening

Divestiture from:

- Tobacco
- Oil and Gas
- Coal
- Etc...

ESG Integration

Enhanced approach for incorporating ESG considerations into investment decisions by identifying both the financial risks and opportunities related to ESG issues.

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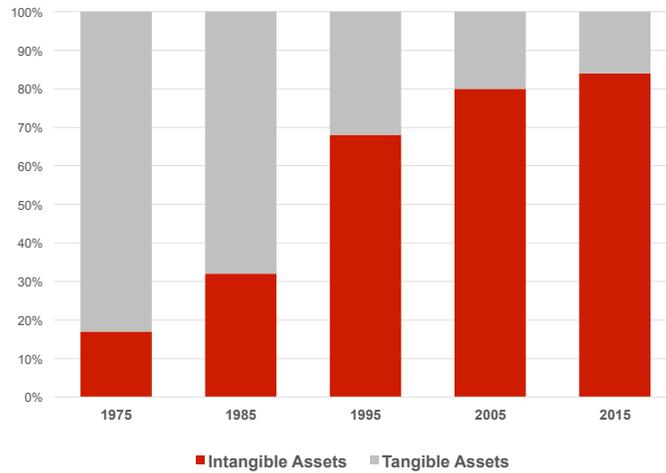
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Why Should Investors Care?

Material sustainability data extends the mosaic of fundamental information

Components of S&P 500 Market Value



Source: Ocean Tomo

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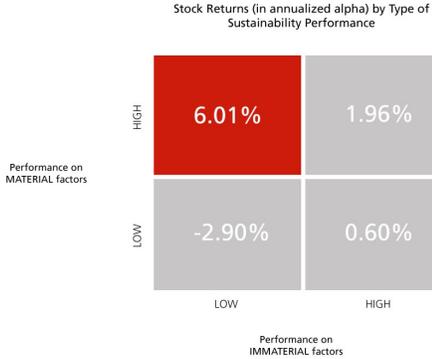
Compelling Research

Harvard research shows SASB's approach drives superior performance



“Corporate Sustainability: First Evidence on Materiality,”

Working Paper by Mozaffar Khan, George Serafeim, and Aaron Yoon
Harvard Business School, 2015



Findings:

- Using SASB's framework, Harvard researchers found that **firms with good performance on 'material sustainability issues' and concurrently poor performance on 'immaterial sustainability issues' enjoy the strongest financial returns**. These results speak to the efficiency of firms' sustainability investments, and also have **implications for asset managers** who have committed to the integration of sustainability factors in their capital allocation decisions.
- They also found that **80 percent of disclosures are immaterial**, having no correlation to positive performance.

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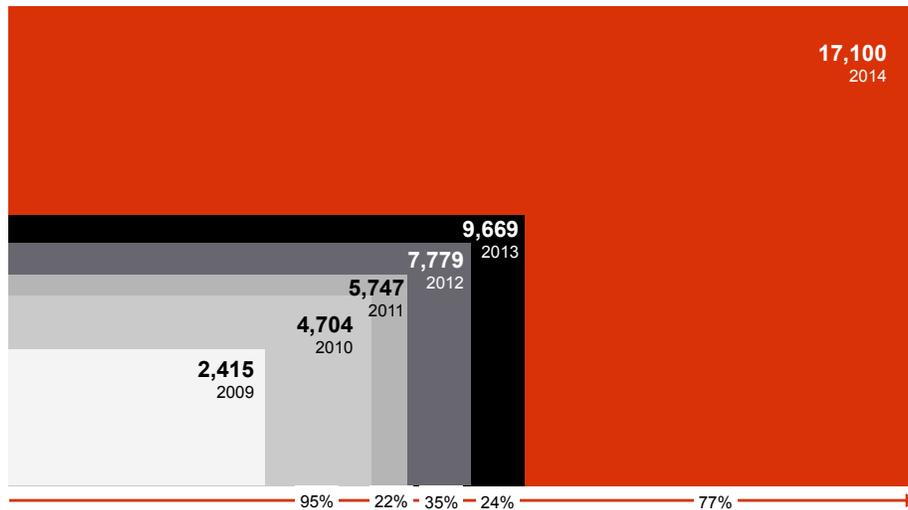
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Growing Demand

Investors and analysts are increasingly seeking out sustainability data

Customers using ESG data on the Bloomberg Professional service:



Source: Bloomberg LP

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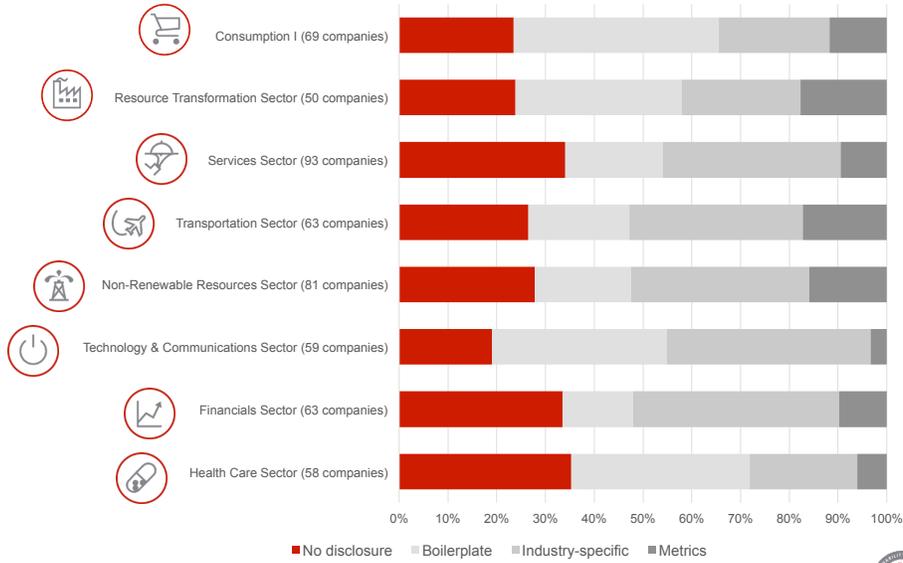
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Current State of Disclosure

Reporting across sectors lacks consistency, comparability, industry-specificity



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Case Studies

Pension Funds and Institutional Investors are interested in sustainable investing from an **alpha-generating and risk-reduction approach**.



- One of the world's largest institutional investors.
- Signatory of the UN's Principles for Responsible Investment, which recognizes ESG factors as critical to investors.
- As of 2015, requires all of its investment managers to identify and integrate ESG factors into their decision-making.
- \$91 billion endowment and retirement funds.
- President's Task Force on Sustainable Investing created to develop framework for the management of ESG considerations for investment decisions.
- UC Regents have voted to divest from coal mining and oil companies focused on tar sands.

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Investor Uptake

Investors use SASB to engage with companies held in their portfolio



Harvard Management Company

Selects companies for engagement based on ESG risks identified as having a direct impact on business operations and shareholder value, risk management oversight and disclosure practices, and the value of holdings.

HMC's current engagement focus is on encouraging better management and disclosure of climate risk among companies in the energy sector. **HMC is encouraging companies in its engagement efforts to use SASB standards** to report material sustainability risks, including climate risk, in their existing public filings so that investors can make more informed long-term investment decisions.



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Fiduciary Duty

ESG integration consistent with fiduciary duty

Pension funds and their trustees have two fiduciary duties:

- **Duty of care**
- **Duty of loyalty**
 - **Duty of impartiality** - Fiduciaries must balance short-term and long-term considerations (*US Supreme Court in Varity v. Howe (1996)*). They must identify and impartially consider the conflicting interests of different beneficiary groups, including those of current and future retirees (*Restatement of Trusts, Third, 1992*).

Duty of impartiality requires competence in long-term value creation and risk management.

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A Market-Driven Response

SASB addresses needs of all market participants—both investors *and* issuers

Issuers

- A minimum set of disclosure topics that are likely to constitute material information for companies in an industry, and a **cost-effective** model for disclosing that information in a **decision-useful** way for investors
- A method to **understand and improve performance** on ESG-related value drivers
- A way to meet the requirements of Regulation S-K

Investors

- **Comparable data** for benchmarking and evaluating performance
- **Standardized, decision-useful information** in a **trusted channel** (i.e., 10-K)
- Tools and resources to analyze and understand sustainability risks and **opportunities** at the company, industry, and portfolio level

SASB INDUSTRY WORKING GROUPS
REFLECT BROAD-BASED INTEREST



>2,800

PARTICIPANTS

\$23.4T

ASSETS UNDER
MANAGEMENT

\$11.0T

MARKET CAP

12

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A Shared Definition of Materiality

SASB is guided by the Supreme Court definition in identifying disclosure topics



*“Material information” is defined by the Supreme Court as presenting a substantial likelihood that the **disclosure** of the omitted fact **would** have been viewed by **the reasonable investor** as having significantly altered the **“total mix”** of information made available.*

TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976)

EVIDENCE OF INTEREST

Issue frequency in five data-driven tests:

- Financial disclosure
- Legal drivers
- Industry norms
- Stakeholder concerns
- Innovation opportunity

EVIDENCE OF FINANCIAL IMPACT

Issue impact on three business value drivers:

- Revenue and costs
- Assets and liabilities
- Risk profile (cost of capital)

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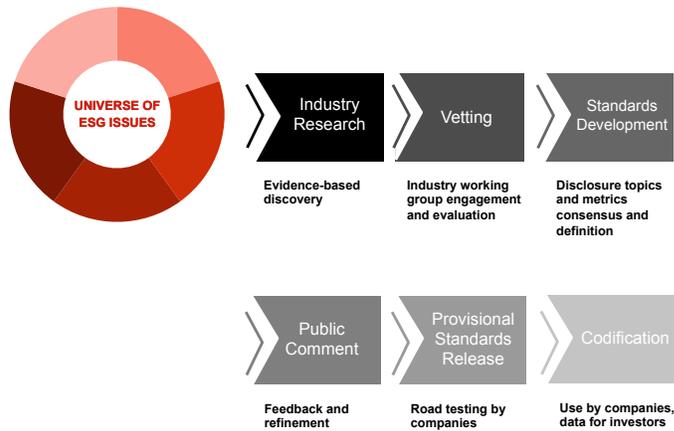
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Rigorous, Transparent Process

SASB standards are rooted in evidence and shaped by consensus



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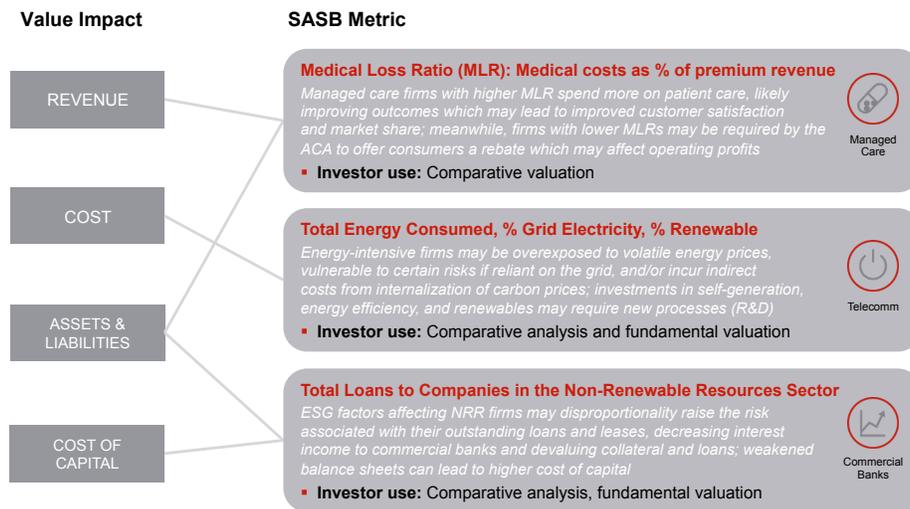
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Explicit Financial Links

Each of SASB's evidence-based metrics is tied to specific financial impacts



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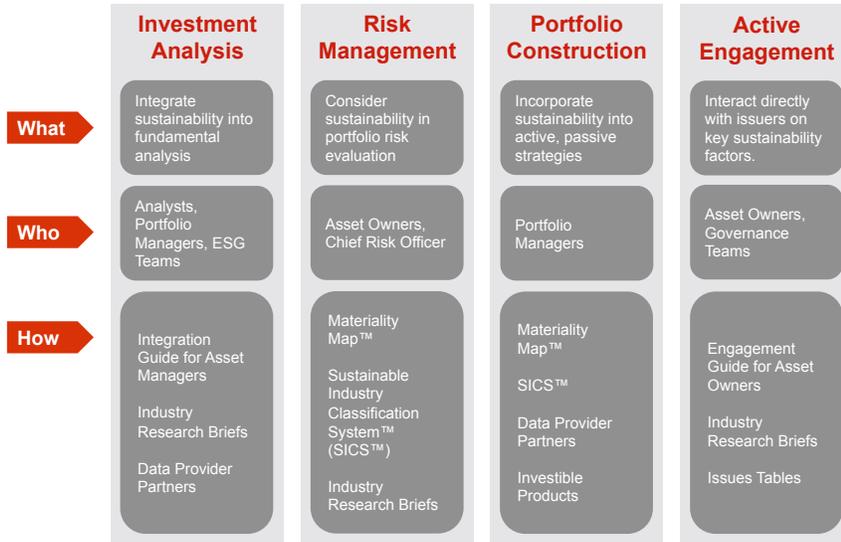
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For a Range of Investors

SASB standards, tools, and resources support a broad range of investment decisions



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Delivering Data

SASB research provides analysts with data on performance and financial impacts

Industry-specific performance

Topic-specific financial impacts

Data availability

SASB Disclosure Topics & Metrics

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A Smarter Benchmark

SASB standards yield performance data, emphasizing quality over quantity



Existing sustainability indexes:

- Maximize data points, masking correlation
- Rely on disclosure as a proxy for performance
- Track the S&P 500

SASB data will spur "smart" investible products using companies' performance on material, industry-specific factors rather than the universe of available data.

Sources: S-Network, Thomson Reuters

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Empowering Investors

SASB is developing guidance for asset owners and analysts



◀ SASB Engagement Guide for Asset Owners



SASB Integration Guide for Financial Analysts ▶

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Making An Impact

SASB standards draw wide interest across the global capital markets

>40,000

STANDARDS
DOWNLOADS
in

>65

COUNTRIES

Top Equity Markets

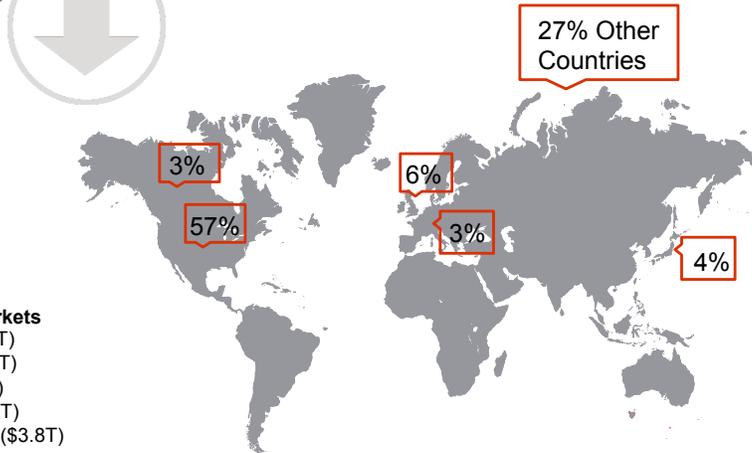
1. U.S. (\$26.5T)
2. China (\$9.6T)
3. E.U. (\$7.8T)
4. Japan (\$4.9T)
5. Hong Kong (\$3.8T)

Source: WFE, June 2015

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What Investors Can Do Now

Engage with companies, members, service providers, and SASB

- Use SASB standards to help guide engagement activities
- Incorporate sustainability into your investment policy statement
- Ask your data provider(s) to incorporate SASB standards
- Share feedback on the Standards and their use in your organization
- Make a statement of support for SASB

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Learn More

Increase your understanding of the link between sustainability and corporate value



Fundamentals of Sustainability Accounting Credential

The world's first credential in sustainability accounting

Level I: Principles

- The context for materiality and sustainability
- How to identify the sustainability factors impacting financial performance

Level II: Practices (2016)

- How to analyze SASB standards for any industry
- How to interpret sustainability information for strategic decision-making or investment analysis

FSA.sasb.org/prepare for curriculum, free resources, and registration



Accounting for a Sustainable Future

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